97-84030-30

Schiff, Mortimer Leo

The financing of present day needs

[New York?]

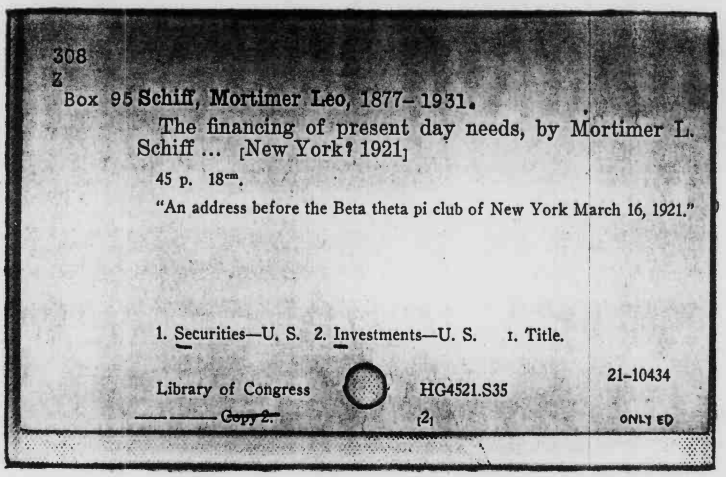
[1921]

97-84030-30
MASTER NEGATIVE #

COLUMBIA UNIVERSITY LIBRARIES
PRESERVATION DIVISION

BIBLIOGRAPHIC MICROFORM TARGET

ORIGINAL MATERIAL AS FILMED - EXISTING BIBLIOGRAPHIC RECORD


308
Z
Box 95 Schiff, Mortimer Leo, 1877-1931.
The financing of present day needs, by Mortimer L. Schiff ... [New York? 1921]
45 p. 18cm.
"An address before the Beta theta pi club of New York March 16, 1921."
1. Securities—U. S. 2. Investments—U. S. I. Title.
Library of Congress
HG4521.S35
[2]
21-10434
Copy 2.
ONLY ED

RESTRICTIONS ON USE: *Reproductions may not be made without permission from Columbia University Libraries.*

TECHNICAL MICROFORM DATA

FILM SIZE: 35 mm REDUCTION RATIO: 9:1 IMAGE PLACEMENT: IA (IIA) IB IIB

DATE FILMED: 2-27-97 INITIALS: PB

TRACKING # : 22127

FILMED BY PRESERVATION RESOURCES, BETHLEHEM, PA.

The Financing *of* Present Day Needs

BY

MORTIMER L. SCHIFF

308
2
Box 95

The Financing *of* Present Day Needs

BY

MORTIMER L. SCHIFF

An address before the

BETA THETA PI CLUB OF NEW YORK

MARCH 16, 1921

Dec. 13, 1922 AE.

GJT 4
The author
4-28-21

SUBJECTS DISCUSSED

I. How Securities Are Marketed 6

Issuing House Buys Securities in Large Lots 6
The New York Stock Exchange a Market Place 7
The Speculator's Place in the Security Market 9
Why the Stock Exchange Should Not be Incorporated . 10
Manipulation of Prices Likely to be a Losing Game ... 10
Issuing Houses and Investment Bankers Buy at Wholesale, Sell at Retail 11
Questions Involved in Corporate Financing 13
The Banker a Professional Adviser 13
Compensation Depends Upon Soundness of Judgment 14
The Banker's Risk in Handling Large Security Issues 16
Offering Must be Complete Success or Failure 17
One Reason for Price Decline 18
Caring for the Financial Needs of Corporations 19
Bankers and the Regulatory Bodies 20
Why Continuing Relations with Bankers are Desirable 21
The Value of Definite Banking Relations 23

II. Regulation and Legislation 25

Regulation Not a Cure-All 25
Driving Bankers Off Railway Boards 27
Service Made Difficult by Legislation 28
Blue Sky Laws and Similar Legislation 29
New York Commission's Report 30
Security Legislation Should be Along Lines of Pure Food Act 34
Information Should be Limited to "Contents" 35
The Test of Price is Value 37
Inventories and Appraisals 37
Licensing of Security Salesmen 39

III. Financing Present Day Needs 41

Problems to be Worked Out 42
The Causes of the Present Situation 43
Public Service Should be the Test of a Security 43
A Time for Conservatism and Confidence 44

The Financing *of* Present Day Needs

THE subject assigned to me is so complex and extensive, that it is not possible to cover all of its many phases within the confines of a brief address. I propose, therefore, to discuss it this evening from but one angle, namely: the financing of domestic industrial needs by the issue of securities and their sale to the public.

By domestic industrial needs, I mean those which have to do with the commerce, transportation and industry of this country, as distinct from governmental, state or municipal requirements.

I do not propose to touch on foreign trade or the European situation, important and interesting as these are, nor on other means of financing, such as extension of credits, the use of acceptances or temporary borrowings, large as is the part these have to play in our economic structure. Finally, I do not propose to review what is past or to prophesy as to the future; both are thankless tasks.

I

How Securities Are Marketed

What are securities?

They are simply evidences of individual ownership in properties or of the amounts owed by the corporation, with a recital of the terms and conditions of such ownership or debt. Theoretically it would be just as simple to inscribe on a registry the names and respective interests of the owners of a property or the amounts due to creditors, but how cumbersome that would make any transfer from one investor to another!

To be attractive, investments must be easily convertible into cash and, therefore, in readily marketable form.

ISSUING HOUSE BUYS SECURITIES IN LARGE LOTS

High grade securities, as a rule, are sold in the first instance in larger lots to issuing houses, whose prestige and experience have developed for them an investment following and whose knowledge insures that the securities in question have the necessary safeguards.

These issuing houses, if the amount involved is large, distribute the risk by forming a syndicate and, generally speaking, sell primarily to the smaller investment houses throughout the country. These dealers, in turn, place the securities with their own customers, and that is what is usually called the secondary distribution.

This ultimate placing among the smaller investors requires for their protection that the market be well maintained until the securities are firmly established, which usually necessitates that the issuing houses and their syndicate be ready to buy and sell at all times the securities in question. Eventually a regular market develops as a rule on the Stock Exchange, although there continue to be private dealings.

THE NEW YORK STOCK EXCHANGE A MARKET PLACE

The relation of the Stock Exchange to dealing in securities appears often to be misunderstood.

It is simply a market place—a meeting place where the buyer and seller or their agents meet to transact business. In itself, it has nothing to do with the sale of securities and simply furnishes facilities for the transaction of business.

It is one of the oldest and most fundamental requirements of trade that there be market places for the exchange of goods and for their purchase and sale.

This is the function that is supplied by the Stock Exchanges, the most important of which in this country is the New York Stock Exchange. At present, the estimated value of the stocks and bonds listed there is in excess of sixty billion dollars.

Our total national wealth is estimated at some three hundred billion dollars, of which at least one-fifth is thus in readily marketable form through the facilities provided by the New York Stock Exchange.

If these were not available, the market for securities would be very much circumscribed and the result would be that it would be far more difficult for the industries of the country to find the funds needed for their purposes.

It is of paramount importance that holders of securities should be able to realize on their investments without difficulty, and this would hardly be the case if there were not regular and active dealings in a free and open market, where there is no falsification of prices and the buyer or seller knows that he pays or receives the ruling market price.

If, on the other hand, dealings were confined to private negotiations, there would be wide differences, such as, for example, we all know often take place in real estate transactions.

THE SPECULATOR'S PLACE IN THE SECURITY MARKET

It must not be overlooked that the speculator —and there is a great difference between a speculator and a gambler—plays a very distinct part in our economic life.

There is not always an investor who wants to increase or decrease his holdings of a particular security, and were it not that speculators are ready to back their judgment as to values or coming conditions, there would be times when transactions would be impossible. The much abused and even more misunderstood short selling has real value at times, as it provides a check against upward movements in prices not warranted by conditions and is a tremendous protection to the market in times of unwarranted and rapid declines.

In speaking of speculation, it should be borne also in mind that the American is by temperament rather a speculator than an investor. He prefers to seek an increase in his capital rather than a somewhat larger return on his invested funds.

There seems to be an impression that most of the speculation is done by members of the Stock Exchange. As a matter of fact, this is far from being the case.

The members of the Stock Exchange are for the most part brokers handling orders simply

as agents for their clients. In addition, statistics show that of these orders only about 20 per cent come from New York and the remaining 80 per cent from the rest of the country.

WHY THE STOCK EXCHANGE SHOULD NOT BE INCORPORATED

One word about the incorporation of the New York Stock Exchange, which has been agitated in some quarters. In my opinion, it would be a very unfortunate thing to do, as it would lessen the control that the Stock Exchange authorities have over its members.

As the situation is now they can and do get rid of undesirables without much difficulty, while if the Stock Exchange were an incorporated body, the proceedings to eliminate those who were doing harm would be far more difficult.

Nowhere in the world is the standard of honesty and fair dealing higher than it is on the New York Stock Exchange and transactions involving millions are often done on simply the spoken word, without any written contract passing until considerably later.

MANIPULATION OF PRICES LIKELY TO BE A LOSING GAME

I do not deny that at times there has been manipulation and particularly in the stocks of companies with a small capitalization closely

held. The Stock Exchange authorities are most vigilant as to this and have given clear evidence of their readiness to apply the most drastic remedies in case of need.

I have often thought that it might be advisable for the Stock Exchange to refuse to list issues of bonds and stocks which are of a lesser amount outstanding than some definite minimum, but this may not be feasible.

Occasionally artificial maintenance of prices has resulted from the pride and confidence in their securities shown by owners of large enterprises, who resent any evidences of under valuation of these securities.

They have usually paid dearly for the experience, not realizing that as a rule market quotations are a fairly accurate barometer of values, as they exist at the moment, and that buying up at artificial prices all that is offered by those who wish to realize on their investment—and particularly if done with borrowed money—is in the long run a losing game and brings its own remedy.

ISSUING HOUSES AND INVESTMENT BANKERS BUY AT WHOLESALE, SELL AT RETAIL

Now as to issuing houses and investment bankers, and their functions. They are the primary distributors of securities; they buy at wholesale and sell at retail.

A banker does not buy for investment; if he did, no matter how large his capital, he would find himself eventually fully invested and unable to absorb any further issues.

He buys for re-sale and bases his purchase price on the price which he expects to be able to secure from the investing public.

The business is done on small margin, out of which selling commissions to dealers throughout the country and other expenses must come, and his profit is, therefore, limited, while the possibility of loss is great if his judgment as to price and type of security should be wrong.

He is like any other merchant who buys at wholesale and sells at retail and, like any other merchant, he must know what wares will appeal to the public and what price market conditions warrant.

It is the merchant, be his wares merchandise or securities, who must use his judgment as to what is marketable and what is not, and the manufacturer, whether his product is merchandise or an issue of securities, must be guided by his advice.

Again, as in the case of the merchant dealing in merchandise, the reputation and prestige for quality of goods and care in their selection is a great factor in securing the following of the buying public.

QUESTIONS INVOLVED IN CORPORATE FINANCING

The questions involved in corporate financing are manifold and need for their solution expert judgment and understanding.

The drafting of a mortgage or the determination of the terms of a preferred stock issue require not only the advice of lawyers to fix the legal details, but also of bankers to determine the features which must be included to create a security which will have the confidence of the investing public and meet its requirements.

But there are even more important questions involved: Shall bonds or preferred stock be issued? If the former, shall they be mortgage bonds, debentures, collateral trust, or convertible; shall they be long term or short term, and, if so, what maturity; is the market more apt to take equipment obligations or mortgage bonds; is it more advisable to make the coupon rate low and sell bonds at a material discount or make it high and approximate par; what safeguards are necessary, and can some with safety be dispensed with?

THE BANKER A PROFESSIONAL ADVISER

In order to determine the type of security, the amount to be offered and the terms and conditions of the issue, exact knowledge is re-

quired, and this can be furnished only by bankers experienced in this line of business, who understand what is necessary to secure adequate response from the investing public and to make the security such as should be offered.

This banking advice is professional in character, and just as corporations consult lawyers on the legal questions involved, so must they consult bankers on the financial questions, in order to avoid mistakes.

The banker, however, does not receive a fee for his advice, judgment and experience, as does a lawyer or other professional man, and his compensation is dependent on the profit which he can realize in handling the securities.

COMPENSATION DEPENDS UPON SOUNDNESS OF JUDGMENT

In addition, differing from other professional advisers, he takes the risk of his advice being good by assuming the financial obligation involved in the purchase of the securities. His compensation, therefore, depends on the soundness of his judgment.

In considering the handling by bankers of corporate financing—and this holds true also of most foreign government loans—it must not be overlooked that such financing is quite a different proposition from selling our Government or municipal bonds.

In the latter case, there is a definite security which, under regulations fixed by law, can be offered for public tender, while in the other, it almost invariably requires much study and thought to determine what type of security can and should be created and what type will be most readily and advantageously salable under existing investment market conditions.

Even in the case of public securities, there is always the chance of no satisfactory bids being forthcoming, but if this happens in the case of a corporation, it would be fatal to its credit and make future financing very difficult, if not impossible.*

In addition, in times like the present, larger amounts of corporate or foreign securities could probably not be sold by competitive bids or public tender, as bankers are disinclined to make any larger commitments and are willing to do so only if the security is just what they think is suitable for offering to the public, and if they are able to go ahead at once with the formation of their syndicate and the distribution of the risk.

They must make their arrangements practically simultaneously with the announcement

* In this connection it is interesting to note that on March 30, 1921, the City of New York offered for public tender $47,000,000 of Revenue Bills and Corporate Stock Notes. Bids for only $26,400,000 were received and of these $5,000,000 had to be rejected. It seems unnecessary to comment on what would be the effect if this had happened to a corporation requiring funds to meet its obligations.

of the transaction and cannot afford to make firm bids to be kept open, subject to acceptance. They must in effect know in advance whether their bid is going to be acceptable, so that they can have their letters, circulars, etc., prepared to proceed with their syndicating and offering to the public immediately after its acceptance.

THE BANKER'S RISK IN HANDLING LARGE SECURITY ISSUES

Many people seem to assume that there is no risk in handling large issues of securities and that there is practically a certain profit to those undertaking the operation.

This is far from being the case. I could quote you many instances, some of quite recent date, where the issuing houses and their syndicates have had to take over large amounts of securities and liquidate their position at a heavy loss.

Mistakes of judgment are made, unforeseen circumstances arise, conditions suddenly change, and what was expected to be a successful offering turns into a failure. Then there are cases where the bankers know in advance that the moment is inopportune and that the public response will not be forthcoming, and still they must go ahead because much needed money must be found for some corporation performing a public service.

It is quite often just these forced transactions that are most in the public interest and the bankers and their syndicates must step into the breach and supply the funds, if the public is not willing to do so. The heaviest losses have frequently been made in securities of the highest quality and undoubted safety.

OFFERING MUST BE COMPLETE SUCCESS OR FAILURE

It is a curious fact, but there is no such thing as a qualified success in making an issue of securities. Either an offering is a complete success or a failure.

The *entire* issue must be sold promptly upon the original offering, in fact, it must be oversubscribed, otherwise the public loses interest and will not buy and the securities become unsalable.

Subscribers to a public issue often subscribe for more than they actually want, expecting a success and a cutting down in allotments, and if they receive all for which they ask, they consider the offering a failure and are apt to throw their holdings on the market for what they will fetch.

It is almost impossible, except in rare instances, to maintain and develop a continuing demand for a certain security, if the original issue has not been an overwhelming success. Even

then it is none too easy to keep the market price at the issue price while the slow process of complete distribution and of absorption by the ultimate investor is going on.

ONE REASON FOR PRICE DECLINE

Frequently, we see large issues of high grade bonds heavily oversubscribed and a few weeks after their market quotation well below their issue price.

Why is this? The securities are just as good as they were before and their price as attractive.

It is as a rule because the dealers and investment houses throughout the country have subscribed for more bonds than they had definitely sold to their customers, doing so because they believed that the demand would continue and that they could gradually place among others of their customers what they had taken for their own account.

If they find themselves mistaken in this, they dispose of their holdings where they can, as they do not wish to lock up their capital. This, if of sufficient volume, may force a material decline in the market price of the security, and that is where the issuing houses and their syndicates must step in and take up the slack until a further distribution among investors can be developed.

An issue cannot be cast adrift to take care of

itself, and it is the duty of the banker in the interest of his clients and of the investing public to protect it until it is firmly established, even if that means the repurchase of large amounts and their ultimate re-sale at a loss.

The failure of an offering is bound to have an injurious effect upon the credit of the issuing corporation, even if the securities are in themselves sound and desirable, and it is, therefore, just as important for the corporation that the securities be offered at the right price and at the right moment as it is for the bankers and their syndicate, who have assumed the financial risk.

CARING FOR THE FINANCIAL NEEDS OF CORPORATIONS

It is equally important that corporations have definite assurance that their financial needs be supplied. They cannot afford to miss the opportunity, particularly if larger amounts are involved, to secure the needed funds on the most favorable terms consistent with the interest of the investing public.

This can be done, however, only if advantage can be taken of the proper moment for the offering of the securities in question, which necessitates making firm contracts with bankers and permitting them to go ahead with marketing the securities.

It is apparent that if the terms of a proposed

contract are disclosed, but the offering postponed until formalities of one kind or another are completed, the risk is great either that others not subject to such formalities will offer their securities in the meantime on more attractive terms or that market conditions may so change as to make the offering impracticable on the terms proposed.

Bankers and their syndicates will not and cannot stand in the breach for an indefinite period and must be in a position to go ahead promptly with the offering, as soon as the commitment is made.

BANKERS AND THE REGULATORY BODIES

In view of the necessity under existing laws to submit security issues of railway companies, for example, to regulatory governmental agencies, bankers in order to facilitate such transactions are ready to make firm contracts, subject to the approval of such regulatory bodies, if they can promptly offer the securities to the public, subject, of course, also, to such approval being secured within a reasonable time.

This is feasible, however, only if contracts made on fair terms are not upset by regulatory bodies.

It is important that public authorities having supervision of security issues, determine a

definite policy in this respect and if, as they should, they permit firm contracts, they must be careful not to interfere, unless it is very clearly evident that the contract is manifestly unfair or unwise in its terms.

A contract must be judged as of the time it is made and not in the light of conditions as they may exist weeks later when the matter is before the regulatory body.

It is clearly unfair to hold bankers to the terms of a contract if there has been a decline in the market for similar securities, pending decision by the regulatory body, and compel them to pay more than the contract price, if market conditions happen to improve.

WHY CONTINUING RELATIONS WITH BANKERS ARE DESIRABLE

Experience has shown that it is best for corporations to handle their financing through the same bankers, because in that way they secure a continuing interest in their financial problems and have at their disposal at all times the advice and experience of such bankers.

It has repeatedly occurred that bankers who have been accustomed to handling the financing of a certain corporation will call to its attention the advisability of undertaking financing at a definite moment, as through the knowledge which bankers acquire in their line of business,

they are often in a position to judge future movements of the investment market, and their recommendation as to when financing is to be done, is, therefore, of great value.

The relationship between corporations and the bankers handling their financing can rest only on service and mutual confidence, and if at any time the bankers do not render fair and adequate service, the relationship becomes an impossible one and must terminate.

On the other hand, bankers are entitled to expect, if their services are satisfactory and their advice and judgment are continuously at the disposal of the corporation, that they shall have the first opportunity to purchase the securities, issued by such corporation, *and particularly so if such securities are created and issued as the result of the advice they have given.*

A banker's stock in trade is his prestige, knowledge, experience, ability, financial and otherwise, to do business, and his only opportunity for compensation is by making a security transaction.

No banker can be expected to work out a financial plan and give the benefit of his advice and judgment and then have his ideas and knowledge placed at the disposal of other bankers and have them, through competitive bids, secure the opportunity for profit, which, as I have stated, is his only chance of compensation.

Another factor which enters into the advisa-

bility of confining the dealing to one leading firm of bankers and not changing from issue to issue, is that the corporation thus secures the full benefit of such banking house's prestige and following.

THE VALUE OF DEFINITE BANKING RELATIONS

The fact that a leading banking house stands sponsor for a corporation's securities is in itself a great advantage to the corporation and results in a better demand for its securities by the investing public.

In addition, by the establishment of definite banking relations, a corporation places itself in a position where, in times of difficulty and of unwilling markets, it can raise money which otherwise would not be forthcoming. The cases are many where bankers have made large sums available for corporations, irrespective of money and investment market conditions, and often at a considerable personal sacrifice to themselves which they would not have done had they not felt a responsibility and duty on account of the continuing relations existing between themselves and such corporations.

All larger corporations, both railroad and industrial, have found it advisable to have continuing banking advice.

This the bankers willingly give, if they have

the assurance that when a financial transaction is undertaken they shall have the first opportunity to handle the securities which may be issued.

Years may elapse, as is often the case, without such a financial transaction, but the bankers give their services without compensation and are at all times ready to advise such corporations with whom their relationship has been firmly established.

II

Regulation and Legislation

It appears to me sometimes that we have gone regulation and legislation mad in this country.

When some situation arises, which needs—or is believed to need—attention, we, or rather our legislative representatives, pass a new law, often economically unsound, or appoint a new commission, or place additional burdens on some already overloaded governmental agency, and then we go blithely on our way, confident that we have applied a remedy, and cease to worry. We have commissions superimposed upon commissions with duplication of functions and conflicts of authority and then we wonder why the wheels of industry and of business do not move smoothly.

REGULATION NOT A CURE-ALL

Do not misunderstand me. I believe in regulation properly applied, but I do not believe that it or legislation are cure-alls. We are sailing on somewhat unchartered seas and must go

slowly, if we are not to run the risk of throttling enterprise and handicapping legitimate business.

The stimulus to hard work and activity lies in management of one's own affairs, and commissions multiplied by commissions, substituting their judgment for those of owners, directors and officers, cannot but have a disastrous result.

As Senator Smoot said recently in commenting on a proposed regulative measure, "Here is a business that has grown in perfection of handling and distributing and now we want to turn it over to be managed by a commission created by Congress. Not a member of that commission could manage successfully any one department of that industry. The commissioners are not going to make investigations personally. Who will? Somebody that has passed a civil service examination, a lot of $1500 and $1600 clerks; more than likely persons who never conducted business to any extent in all their lives. Who is to issue the orders and regulations? Men who know nothing about the business."

New experiments are often received enthusiastically, but it does not necessarily follow from this that they are economically sound or will work for the benefit of the nation as a whole.

Unfortunately regulation in its final analysis is often the substitution of the judgment of some obscure clerk of a commission or of a government

department for that of those in charge of the enterprise.

You cannot make men honest by legislation and the crook will find other means to accomplish his ends, while the reputable business man is throttled. I believe in regulation to stop abuses, special privileges and unfair practices, but let us be sure first that these exist and that they will be cured by the means proposed.

DRIVING BANKERS OFF RAILWAY BOARDS

The much discussed Section 10 of the Clayton Act now in force is driving bankers off railway boards, so as to prevent their dealing with such companies.

Consider the absurdity of this. If such bankers really controlled a company, all they would have to do would be to put on dummy directors who would simply follow their instructions.

If they do not control—and I know of no important railway company controlled by bankers—it shows a poor opinion of American business men, acting as officers and members of the Board of Directors of such companies, to believe that they would let themselves be influenced by a banker on the board to do improper acts or to make unfavorable trades with him in their securities.

In my experience, and it extends now over

twenty-five years, I have known of no cases where bankers serving as railway directors have taken advantage of such companies in handling their securities and, in fact, in not infrequent instances they have paid more than the securities were worth, with resulting heavy losses to themselves and their syndicates.

It seems also to have been overlooked that a member of a board of directors is acting in a fiduciary capacity and that if a banker-director, like any other director, does a dishonest act, he is guilty of fraud and can be punished under the penal statutes.

The great bulk of capital of the railways of this country has been raised by bond issues and the investors holding these bonds naturally look to the issuing bankers to protect their interests and watch the management of the companies in question.

SERVICE MADE DIFFICULT BY LEGISLATION

The best way in which they can keep in the close touch that this requires and in which they can make their advice and judgment effective, is by service as directors and this service they are now prohibited from performing on pain of ceasing all business connections with such companies. It is true that the law provides that they may do so on a competitive basis, but that,

as I have already pointed out, creates an impossible situation.

I can assure you that it is no particular pleasure to give one's time and attention as a director of a corporation; the responsibility is great and the compensation small, but bankers have assumed the burden because of the duty they owe to their clients and the investing public.

I resent the implied charge that bankers cannot be trusted to deal fairly with such corporations. They are not dealing with themselves, but with the officers of the companies, who are quite independent and very keen to make the best bargain they can. The record tells the story and, as far as I know, there have been no cases of reputable bankers paying anything but a fair price for the securities of railway companies on whose boards they have been represented.

BLUE SKY LAWS AND SIMILAR LEGISLATION

I realize that the regulation of the sale of railway securities has probably come to stay and I have simply tried to point out some of the pitfalls and difficulties that should be avoided.

I realize further that there is a tendency to extend and enlarge by legislation the regulation of security issues. The most popular method for this appears to be the so-called "Blue Sky Laws."

I am of the opinion that legislation on this subject is very apt to fail in its purpose and, while restricting and interfering with legitimate business, does not prove effective in preventing the exploitation of the ignorant by unscrupulous promoters.

Where necessary there should be a strengthening of the criminal statutes, particularly those defining and dealing with fraud, and the provision by Federal, State, County and Municipal authorities of sufficient funds to enable officers of the law to discover, prevent and punish fraudulent practices.

In 1919, Governor Alfred E. Smith, of the State of New York, appointed a commission to study this subject, of which I had the honor to be a member.

NEW YORK COMMISSION'S REPORT

I cannot do better than quote from the majority report of that commission, which was signed by Alfred J. Johnson, former City Chamberlain; William H. Porter, of J. P. Morgan & Co.; John J. Pulleyn, President of the Emigrant Industrial Savings Bank; William H. Remick, President of the New York Stock Exchange; Charles H. Sabin, President of the Guaranty Trust Co.; John G. Saxe, former State Senator; Edwin C. Vogel, of

Arthur Lipper & Co., and myself. This report said in part:—

> "Your Committee deems it necessary to distinguish sharply between the various classes of losses. A large portion of losses result from ignorance, and another large proportion of losses result from the cupidity of people who engage in speculation seeking abnormal gains. The only losses with which we are concerned at this moment are the losses which are occasioned by fraud.
>
> It is impossible by legislation to abolish ignorance or eliminate cupidity. Moreover, experience has demonstrated that no matter what statutory bars may be erected, men will continue to lose their money not only by unwise investments and extravagant speculation, but that the ingenuity of the crook can never be wholly circumvented by statute.
>
> No formula of words, no mathematical computations dependent on automatic operation can make an efficient trap to catch the crooked dealer.

What is needed is a flexible, virile fraud-hunting State machinery driven not by statute but by human intelligence and human activity.

The promotor and vendor of spurious stocks does not operate along conventional lines—nor can he be persuaded to do so by any statute which we might recommend, or the Legislature might enact. On the contrary, during the interim periods of legislative action, he could be counted on to abandon certain lines which might be marked as legally dangerous and adopt new lines that would be safe until a future Legislature should discover and pick up the trail of dishonesty.

Common sense dictates that the State shall not place its dependence on legal traps composed of words, which, no matter how well chosen, are notoriously easy of evasion.

While, theoretically, we all believe that a statute which merely enforces "publicity" might have some beneficial effect, nevertheless, a careful study of any law which has been enacted, or any bill which has been proposed, absolutely

convinces us that provisions of this character place an unwarranted handicap on legitimate financial transactions to a degree that would be intolerable.

It would act as a prohibition or deterrent to responsible reputable dealers; it would not restrict the activities of those without scruple or regard for their spoken or written word.

The individual who proposes to lend his money to assist a legitimate security will hesitate or abandon the project if he is confronted by the necessity of elaborate statistical data which he is called upon to verify and for which he will be held civilly and criminally responsible. The unscrupulous individual who proposes to issue a worthless security will not hesitate at the mere filing with a public official of any statement, even though he knows it to be untrue. The honest and the careful dealer is placed in shackles, whereas the crook and the careless man is virtually unhampered.

There are those who urge that the British Companies Act, which provides for a system of verified statistical de-

tail, imposing responsibility on the persons verifying the statement, has worked well. England, however, is a country with a single financial centre, whereas New York State is one State of a union, and can neither legislate as to the issuance of securities in other States, nor afford to drive capital into other States. Conditions in England are otherwise wholly different from conditions in the United States. For instance, the bond salesman, of whom we have thousands, and who conducts a large business between the investment banker and the public, is unknown in England. Moreover, we have received many reports to the effect that the British Companies Act has not succeeded in preventing fraudulent dealings in securities. There is probably no market in the world where highly speculative securities are more common than in London."

SECURITY LEGISLATION, IF ANY, SHOULD BE ALONG LINES OF PURE FOOD ACT

There is little for me to add to what has been so well stated in this report. While I do not believe that the ignorant and those who want to get rich quick can be helped by legislation,

or the crook put out of business, except by penal statutes, one thing is clear and that is, if there is to be legislation, it must be along the lines of the Federal Pure Food Act, so as to give publicity as to what the security is and the property behind it, but not as to its value. It must not go too far, however, and must not be such as to interfere with legitimate business.

Just as the Pure Food Act does not attempt to tell people what is good for them to eat and what is not, just so must we avoid in security regulation trying to guide the public as to what they should buy and what they should leave alone.

INFORMATION SHOULD BE LIMITED TO "CONTENTS"

Information must be limited to certain simple data and to what might be called the *contents* of the security, but the public must itself determine whether the price asked is a fair one and represents the value of the security. Some advocate the disclosure of the cost to those offering the security, but this has as little bearing on the value as it has in the case of any commodity offered for sale.

If we buy a diamond at a jeweller's or a tin of preserved goods at the grocer's, we do not ask what it cost the distributor, but want to have information as to its quality. In the case of the

diamond, we want to know its perfection, weight, etc., and in that of the preserved goods their ingredients, but we determine for ourselves whether they are worth to us the price we are asked to pay.

The same should hold true of securities, and I can see as little justification to demand of those offering them that they disclose the profit they make in the transaction, as to require any other merchant to label his goods with their cost price.

As a matter of fact, most high grade security business—and this holds particularly true of bond issues—is done on a very small margin, but there are instances of perfectly legitimate and sound transactions where a material profit is made and where, notwithstanding this, the securities are offered to the public on advantageous terms.

A disclosure of such profits would, however, give rise to misapprehension and misunderstanding, and as a result in many instances prevent transactions which are in the public interest.

I know of no other business where it is required that one who has, for one reason or another, been able to buy advantageously, is prevented by the force of public opinion from selling at a fair market price.

THE TEST OF PRICE IS VALUE

The test of the price of a security, just as of any other article, is not what profit has been made, but whether the price is justified by the value of the goods. Not even the New York Stock Exchange, rigid and complete as its listing requirements are, requires any such disclosures. These requirements do not include any elements which have no bearing on the value of the security.

In this connection it must not be overlooked that listing on the New York Stock Exchange takes place *after* securities have been sold and distributed, not before.

Even so, there are important companies, whose securities are entitled to the highest investment rating, who have refused to list them on the New York Stock Exchange, because this would make available to their competitors information which, in the interest of their shareholders, they believe they should not disclose. Such or similar requirements by Federal or State statutes would render impossible the sale of any securities by such corporations.

INVENTORIES AND APPRAISALS

I know of cases where in certain States, desirable and in every way attractive securities could

not be offered, because those offering them were unwilling or unable to comply with certain statutory provisions.

We should learn from the experience of France, whose rigid, narrow and expensive fiscal requirements prevented the introduction in her market of many high grade and desirable investment securities, while admitting many practically worthless securities for sale to the public.

Much value is attached by some to a published inventory and appraisal.

It is of no value in case of fraudulent promotions, as dishonest appraisers can always be found, and, in the case of legitimate transactions, the delay which this would cause, until such inventories and appraisals were made, would often render impracticable the offering of their securities. This is apparent and seems to me to require no further elucidation.

Furthermore, in the case of larger corporations owning property of different kinds in many different localities, a detailed inventory would be of tremendous length and from a practical standpoint most difficult to furnish.

In addition, there would be great objection to this on the part of corporations engaged in competitive business, as they would be very much disinclined to make available to their

competitors such detailed information about their affairs.

In connection even with the highest types of securities, it is often not possible to determine all their details at the time of issue and certain of these must be left to the judgment of the issuing bankers. Where large sums of money are involved, it is generally of paramount importance that the psychological moment should be chosen for the issuance of the securities and if it were necessary to wait until all of the details were put in final form, the result might be very disastrous to the borrowing or issuing corporations.

LICENSING OF SECURITY SALESMEN

Some propose the licensing of security salesmen. Experience has shown that this is often ineffective and leads to abuse.

Such licensing is bound sooner or later to become perfunctory in character, and one case of a license in the hands of a dishonest salesman will do more harm than any possible good resulting from such a system.

To the ignorant, the signature of an official of the State on such a license means the approval by the State, not of the individual salesman, but of the security offered, and is apt to be used as a selling argument by those exploiting the ignorant, who after all form the bulk of those

to whom worthless securities are sold. It will be almost impossible to prevent salesmen of this type receiving licenses, and to withdraw them *after the damage is done* will prove of little remedy.

A licensing system to be effective would entail such rigid requirements in order to secure a license as to prevent many worthy people—particularly those just entering upon their business careers—from engaging in the sale of securities, while one which is perfunctory in character would be no protection. Revocation after discovery of wrong doing is much like locking the stable door after the horse has been stolen.

It is perhaps appropriate to point out and emphasize again that there is such a thing as prestige and reputation.

The reason that some issuing houses can handle large issues is because by years of care and probity they have proved to the investing public that they scrutinize carefully all offerings which they make and do not offer any securities which fail to meet their rigid requirements. From them the public will buy, even if it does not from others whom it does not know or in whom it has not confidence.

III

Financing Present Day Needs

In working out present day needs, all elements in the community must co-operate.

There must be mutual faith and understanding. Capital must do its share and so must labor. Each must realize the difficulties and problems of the other.

As Vice-President Coolidge has well said: "There are evil forces at work now. They are apparently organized and seek the disintegration of society. They can almost always be recognized by the direct appeal they make to selfishness and to nothing else. They deny that the present relationship of men to each other, which exists by reason of organized society, has any sound basis for its existence. They point out to men with untrained minds that it takes effort to maintain themselves and support government, and claim that they ought to exist without effort on the accumulation of others, and they deny that men have any obligations toward each other."

PROBLEMS TO BE WORKED OUT

There is no short cut to creating an ideal world. We must work out our problems, bearing in mind that there are two sides to every question.

We are living in difficult times; we must learn by the experiences of the past and try to avoid pitfalls and mistakes. There is no easy road to success and get-rich-quick methods can lead only to disaster.

Credit and prestige are delicate things, which must be guarded carefully in order to be preserved. This is no time for experiments and sound old-fashioned principles of finance will prove most effective in the long run.

A distinguished English publicist has recently said that the three requisites for success are judgment, industry and health. To these, I would add, accuracy and concentration.

I have never been convinced of the soundness of the old adage: "Do not put all your eggs in one basket." I am not sure but that it is often better to do so and to *watch the basket and its contents carefully.*

Eternal vigilance is the price of safety, and as Postmaster-General Hays frequently said in the recent campaign: "Things do not happen, they are brought about."

THE CAUSES OF THE PRESENT SITUATION

Many things have contributed to the present situation.

There has been the war with its fearful waste in human lives and treasure.

There is Europe struggling with a peace treaty built on unsound economic lines.

There has been too much wild-cat promotion, too many indigestible securities forced on unwilling markets for political and other purposes, too much speculation by those whose time and energy should have been devoted to their own business, too much short time borrowing for capital and unrelated expenditures and too much paternalism and interference with primary economic laws.

PUBLIC SERVICE SHOULD BE THE TEST OF A SECURITY

The real test of a security is its quality, not its salability, and bankers must have the courage to refuse accommodations to their customers if wanted for unsound purposes. It is not a question of whether a security issue will be absorbed by the public, but whether it is one which should be offered to the public.

I know it is a natural temptation to bankers to make a profitable transaction by offering to the public a readily salable security

on attractive terms, but they should not do so if the security, even if otherwise good, is issued for an unsound purpose. Bankers must scrutinize most carefully every security they offer and make sure that it is such as they can recommend without hesitancy.

I do not agree with the famous speculator who said: "There is no such thing as an investment; either you get stuck or you don't."

It is the function of the banker to determine what are investment securities and what are not, and upon the manner which he does this depends the confidence in his judgment and his investment following.

He will not go far wrong if he sticks to established enterprises, managed by men who know their business, and leaves to others the promotion and sale of securities based on capitalized hopes.

It has been said that when capital seeks management, capital loses, but that when management seeks capital, capital wins. That is undoubtedly true and is well worth remembering.

A TIME FOR CONSERVATISM AND CONFIDENCE

This is a time for conservatism, but also for confidence: confidence in ourselves and our neighbors, confidence in our country and its

possibilities, confidence in our form of government and, finally and most important, confidence in our business men and their honesty.

The present day need is for common sense, not nonsense; for sound thinking, not wild ideas; for realities, not theories; for fixity of purpose, not sail trimming; for frankness, not bluff; for accuracy, not guesswork; for thrift, not waste; for hard work, not loafing; for cooperation, not individualism; for fellowship, not class hatreds.

It is only thus that order can be restored in the world and a sound economic situation be created.

This book is due two weeks from the last date stamped below, and if not returned or renewed at or before that time a fine of five cents a day will be incurred.

MAR 12 1981

6	-	12
3	-	3
3	-	
3	-	
1	-	4
1	-	2

21

3
6
4
2

22127

END OF
TITLE